Public Service Commission of Wisconsin

Ellen Nowak, Chairperson
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610 North Whitney Way
P.O. Box 7854
Madison, WI 53707-7854

May 1, 2017

To the Parties:

Re: Application of Wisconsin Electric Power Company, Wisconsin Gas LLC, and Wisconsin Public Service Corporation for Declaratory Ruling and Approval Regarding Long-Term Natural Gas Storage and Transportation Arrangements — 5-DR-112

Comments Due:	Address Comments To:
May 15, 2017 – 1:30 p.m.	**Sandra J. Paske** Public Service Commission P.O. Box 7854 Madison, WI 53707-7854
This docket uses the Electronic Records Filing system (ERF).	

The Commission requests comments on the Commission staff memorandum concerning the application of Wisconsin Electric Power Company, Wisconsin Gas LLC, and Wisconsin Public Service Corporation for declaratory ruling and approval regarding long-term natural gas storage and transportation arrangements. Party comments must be filed using the ERF system. The ERF system can be accessed through the Public Service Commission's website at http://apps.psc.wi.gov. Members of the public may file comments using the ERF system or may file an original in person or by mail at Public Service Commission, 610 North Whitney Way, P.O. Box 7854, Madison, WI 53707-7854.

Please direct questions about this docket or requests for additional accommodations for the disabled to the Commission's docket coordinator, Kate Christensen at (608) 267-2893 or kate.christensen@wisconsin.gov.

Sincerely,

Sandra J Paske

Sandra J. Paske
Secretary to the Commission

SJP:ev:jlt:DL: 01534420

Attachment

PUBLIC SERVICE COMMISSION OF WISCONSIN
Memorandum

May 1, 2017

FOR COMMISSION AGENDA

TO: The Commission

FROM: Jeffrey J. Ripp, Administrator
Carrie Templeton, Assistant Administrator
Kate Christensen, Program and Policy Analyst
Enrique Bacalao, Economist
Division of Energy Regulation

RE: Application of Wisconsin Electric Power Company, Wisconsin Gas LLC, and Wisconsin Public Service Corporation for Declaratory Ruling and Approval Regarding Long-Term Natural Gas Storage and Transportation Arrangements — 5-DR-112

Suggested Minute: The Commission issued a declaratory ruling finding that:

(1) It [is/is not] reasonable, prudent, and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility;

(2) It [is/is not] reasonable, prudent, and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective purchase gas adjustment clauses based upon annual demand requirements; and

(3) It [is/is not] reasonable, necessary, and in the public interest to impose conditions upon the applicants in connection with their decision to enter into the proposed agreements and contracts.

BACKGROUND

On February 3, 2017, Wisconsin Electric Power Company (WEPCO or WE-GO), Wisconsin Gas LLC (WG), and Wisconsin Public Service Corporation (WPSC) (collectively, applicants), petitioned for declaratory rulings concerning the reasonableness and prudence of a

proposed natural gas storage and transportation transaction (the proposed transaction). (PSC REF#: 297633, confidential; PSC REF#: 297634, public.) The applicants state that the proposed transaction will allow them to secure one-third of their natural gas storage and associated transportation needs, reduce reliance on shorter-term leases and a dominant provider of storage services, and deliver $200 million in net present value (NPV) savings to customers over the life of the proposed transaction. The applicants further state that the proposed transaction is appropriate and timely because the demand and cost for natural gas storage and interstate transportation will rise in the near future since the demand for natural gas is increasing for electric generation, exports, and liquefied natural gas production.

Gas Storage Agreements

Under the proposed transaction, the applicants' holding company, WEC Energy Group, Inc. (WEC), will acquire Bluewater Natural Gas Holding, LLC (BGH), which owns underground natural gas storage facilities in Michigan, for a total acquisition cost of $230 million ($225 million purchase price plus $5 million in transaction costs). The applicants state that they are familiar with BGH's Bluewater facility because they currently lease much of its capacity. The applicants state that the Bluewater facility is a relatively new facility that is less likely to require major investments in the near term. Once WEC acquires BGH, the applicants propose to enter into long-term, sixty-year storage service agreements with BGH's subsidiary, Bluewater Natural Gas Storage LLC (BGS),[1] under an existing Federal Energy Regulatory Commission (FERC) approved market-based rate tariff, on terms comparable to ownership that allocate storage capacity to each applicant in proportion to its peak-day demands. The applicants state

[1] Where the application refers to BGH and BGS collectively, this memorandum uses these abbreviations somewhat interchangeably as well.

that the proposed transaction is structured in this manner to insulate the applicants from the risk of owning the Bluewater facility and to avoid the need for BGS to cancel its market-based rate tariff and the need for the applicants to establish new market-based rate tariffs with FERC.

Market-based rates allow BGS to offer any filed tariff service at rates higher or lower than the cost to provide them. In order to be granted market-based rate authorization, an entity must prove that it does not have market power in the region in which it operates. An entity may prove that it does not have this market power using the Herfindahl-Hirschmann Index, which analyzes the market power of the entity itself and the concentration of the market. In general, an entity is considered to have market power if any of these criteria are met: (1) the entity owns or controls 10 percent or more of working gas storage capability in the regional market; (2) the entity owns or controls 10 percent or more of maximum deliverability in the market; or (3) there is an absence of storage options for natural gas shippers. BGS's geographic market includes Michigan, northern Illinois, northern Indiana and Western Ontario. (PSC REF#: 300792.)

Typical storage contract rates consist of firm storage reservation charges and firm injection and withdrawal charges. The applicants have negotiated a base reservation charge based on various annual costs and revenues. (PSC REF#: 300793; PSC REF#: 299840 at 4.) To the extent there is a difference between the forecasted estimate and actual costs, both positive and negative, a true-up component mechanism will take this difference and apply it to the base rate as a true-up surcharge or credit. (PSC REF#: 299840 at 4.) This arrangement provides the applicants the flexibility to operate the storage facility as if they owned it. As stated by the applicants, the total annual estimated costs and revenues included in the base reservation charge consist of the following BGS annual cost components:

- Bluewater purchase (return on and of investment)
- Book depreciation

- Base gas (recoverable)
- Interest expense
- Return on equity
- Income tax
- Property tax
- Operation and maintenance (O&M), and capital expenditures[2]
- Existing storage revenue
- Off-system contracts
- Off-system park and loan contracts[3]

(PSC REF#: 300793.) Any existing third-party storage revenue will be passed along to the applicants and subtracted from the base reservation charge. (PSC REF#: 299838.)

The applicants indicate that the base reservation charge includes book depreciation and is based on the total cost of $230 million amortized over a sixty-year term ending March 31, 2077. (PSC REF#: 300793, public; PSC REF#: 300799, confidential.) However, they also indicate that the Manlove Field underground storage facility, which is owned by another WEC subsidiary, is used as a proxy for the net present value study upon which the applicants base their assumptions for the Bluewater facility, further discussed below. The depreciable life of Manlove Field is estimated at 94 years. (PSC REF#: 297634, public, Attachment 5 at 3.) The applicants' analyses assumed that there would be zero salvage value for the Bluewater facility, but the applicants anticipate that the Bluewater facility will continue to operate after the sixty-year term expires. (PSC REF#: 299838.)

Where the applicants' proposed depreciation does not include a longer service life or a salvage value for the facilities, the resulting depreciation expense is 1.5 times greater than would

[2] Capital expenditures would not be recovered entirely in the year they are incurred, but instead capitalized.
[3] In some years there may be revenues for the park and loan arrangement, but historically for the Bluewater facility the park and loan has been an expense. Therefore, applicants have forecasted this as an expense over the 60 years.

otherwise be incurred over the life of the Bluewater facility. Commission staff notes that the Bluewater facility will likely retain some residual value. For example, assuming straight-line depreciation for the plant, equipment, 90 percent of base gas, and the acquisition premium, depreciation would be equal to:

$$\frac{a-b}{c} = Depreciation\ Expense$$

Where: *a=net book cost of plant and equipment + 90% of base gas + acquisition premium*
b=net salvage value
c= estimated service life

The proper depreciation expense of the facilities incorporated into the proposed base reservation charge would either incorporate a longer service life or a net salvage value to reflect the residual value of these facilities after the sixty-year term. While this proposed treatment of depreciation could impact the base rate, which has already been negotiated by the parties, it is important to note that to ignore a longer service life or a net salvage value in determining depreciation expense could inflate costs, and in turn, the amount paid by ratepayers.

A similar issue related to the gas storage contract rate is the acquisition premium itself. The applicants identify the acquisition premium as approximately [redacted]. (PSC REF#: 300798, confidential; PSC REF#: 300799, public.) This amount consists of the difference between Bluewater's original cost basis and the purchase price. The acquisition premium is important to note because typically, a public utility who acquires plant must justify recovery of the acquisition premium through base rates by satisfying the following criteria:[4]

1. From the purchasing utility's customers' standpoint:

   A. It will bring in net revenue: Revenues > Incremental Costs

[4] These criteria are based on an internal Commission memorandum dated April 17, 1985.

1. Revenues are: those estimated to be generated by the selling utility's customers.
2. Incremental costs can include but are not limited to:
    a. the acquisition amortization (over 3, 5, or 10 years)
    b. the additional return associated with unamortized acquisition
    c. incremental costs of construction improvement or upgrade
    d. incremental depreciation
    e. incremental taxes
    f. personnel reduction

Thus, while the applicants included the acquisition premium as a component of the proposed base reservation charge under the existing FERC tariff rate (PSC REF#: 300799), the criteria above demonstrate that recovery of the acquisition premium typically is not guaranteed. In this case, the Commission may be preempted from disallowing the acquisition premium from rates. But if the Commission believes that it has the authority to disallow the acquisition premium from rates, the cost recovery method is important to that decision, as discussed below.

Last, the applicants proposed that the Commission will have an opportunity to review and approve recovery in rates of material capital expenditures, which the applicants define as those in excess of $7.5 million. (PSC REF#: 299840 at 5.) The applicants state that this amount was determined based on the current Certificate of Authority (CA) natural gas threshold of $2.5 million multiplied by three since there are three applicants. However, Commission staff notes that if this were a direct ownership scenario, Wis. Stat. § 196.49(5)(ar)1m. establishes that the estimated *gross* cost of a proposed project is to be used when determining whether a project exceeds the CA cost threshold. As such, rather than a value "three times" the statutory natural gas threshold, reflecting the three "owning" applicants, the CA threshold in a direct ownership

scenario would be equal to “one times” the threshold defined in Wis. Stat. §196.49(5g)(ar)1m.d., regardless of the fact that there would be three “owning” applicants.

Gas Transportation Contracts

The applicants further state that the Bluewater facility is well connected to interstate pipelines. The applicants state that transportation from the Bluewater facility to the Guardian Pipeline (Guardian) to which the applicants are connected is available at very low cost. The applicants propose to use firm natural gas transportation capacity currently available on the Vector Pipeline system (Vector) to deliver gas to and from the Bluewater facility. Gas withdrawn from the Bluewater facility will be transported to Vector’s interconnect with Guardian in Joliet, Illinois.

The applicants currently contract nearly half of their firm storage and associated transportation requirements from ANR Pipeline Company (ANR). (PSC REF#: 297634 at 9.) The current ANR contracts are cost-based bundled storage and transportation services, most of which are at or near ANR’s maximum tariff rate. (*Id.*, Attachment 5 at 20-24.) The applicants also currently contract over 90 percent of Guardian’s firm transportation capacity to bring gas into Wisconsin. The applicants lastly have existing transportation contracts with Vector, which interconnects with Guardian.

The applicants propose to utilize their existing Vector contacts, as well as enter into new long-term, firm transportation rates for 20 years, to facilitate gas storage withdrawals. (*Id.*, Attachment 3 at 3, Attachment 5 at 16-17.) The contracts the applicants have negotiated with Vector for withdrawals include a ramp up of firm transportation capacity as additional Bluewater storage comes available. (*Id.*, Attachment 3 at 3.) At such time when the withdrawal contracts expire, the applicants will have negotiation rights for extension upon expiration. (*Id.*,

Attachment 5 at 16.) The applicants also propose to contract with Vector [redacted] for gas storage injections. Vector provides the applicants with the ability to source gas from either the Joliet Hub or the Dawn Hub. These [redacted] contracts for injection are reasonable as they will allow the applicants flexibility to source gas from whichever hub is the least expensive.

Economic Analysis

As more thoroughly discussed below, the applicants conducted an economic analysis to derive the proposed transaction's $200 million in NPV savings to customers, which Commission staff evaluated. The applicants compared the costs of the proposed transaction to the costs they would incur using traditional portfolios of services on a shorter-term basis. The applicants state that the cost savings are threefold. The applicants will save costs on storage and transportation and the proposed transaction will allow the applicants to quickly adapt to market conditions. The applicants can also earn revenue by offering services to third parties. The applicants state that the return of and on the upfront cost of acquiring the Bluewater facility will be the highest in the first year and will then decrease over time as it is depreciated. Thus, the applicants state that the proposed transaction's costs will exceed its savings in the first few years.

Recovery of the Proposed Transaction's Costs

The applicants propose to recover firm storage reservation charges and transportation contract charges through their respective purchase gas adjustment clauses (PGACs). The applicants propose to initially recover their net storage costs from retail customers based upon annual demand requirements. The applicants must serve all of their customer load and balance all gas supplies delivered to their distribution system. Where the applicants will have flexibility in the use of the Bluewater storage facility throughout the year, it is reasonable for the applicants

to recover the net storage costs from retail sales based upon annual demand requirements. The appropriate cost recovery mechanism, however, will be more thoroughly discussed below.

For instance, using the existing PGAC mechanism to recover all of the applicants' charges allows one-for-one recovery of all costs. One-for-one gas cost recovery methods permit local distribution companies (LDCs) to price gas supplies aggressively for competitive markets without fear of under recovery of gas costs. *See Order in GCRM Docket*, Docket No. 5-GI-106, 1996 WL 34720600, at *15 (Pub. Serv. Comm'n of Wis. Nov. 8, 1996). A gas cost recovery mechanism, such as the PGAC, should "be designed in a way that the sharing of risk does not motivate actions that significantly and adversely affect the goals associated with reliable service and reasonable gas costs to customers." *Id.* at *13. It is important for the Commission to balance the risk-reward relationship among shareholders and ratepayers in allowing a public utility to use a gas cost recovery mechanism such as the PGAC.

Requested Declaratory Rulings

The applicants' petition for declaratory ruling requests two declarations from the Commission under Wis. Stat. § 227.41. First, the applicants request that the Commission declare that it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements. Second, the applicants request that the Commission declare that it is reasonable and prudent for the applicants to recover their allocated portions of the costs to acquire, operate, and maintain the Bluewater facility through their PGACs. The applicants also request that the Commission approve an amendment to the WEC Affiliated Interest Agreement to ensure that BGH has access to the full range of services available within WEC through its service company and the operating companies. The Commission has

determined that it will address the applicants' request to amend the WEC Affiliated Interest Agreement in separate dockets, 6630-AI-102, 6650-AI-100, 6690-AI-102.

Procedural History

Commission staff issued a number of data requests to which the applicants have responded. These data requests concern: (1) rates and cost allocation (PSC REF#: 299839, confidential; PSC REF#: 299840, public); (2) procedural and jurisdictional matters (PSC REF#: 299835); (3) business and contractual matters (PSC REF#: 299836); (4) economic and financial matters (PSC REF#: 299837); (5) salvage value, seasonal spreads, and reservation fees (PSC REF#: 299838); and (6) miscellaneous matters (PSC REF#: 300792; PSC REF#: 300793; PSC REF#: 300794; PSC REF#: 300795; PSC REF#: 300798, confidential; PSC REF#: 300799, public; PSC REF#: 300796; PSC REF#: 300797.)

On March 23, 2017, Commission staff issued an agenda memorandum concerning whether the Commission should grant the petition and issue a notice of proceeding setting the matter for hearing or deny the petition and issue an order containing a brief statement as to the reasons why. (PSC REF#: 299828.) On March 24, 2017, the Commission issued an Order Opening Docket and Notice of Prehearing Conference. (PSC REF#: 299966.)

The Order Opening Docket and Notice of Prehearing Conference proposed three issues: (1) whether it is reasonable, prudent and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility; (2) whether it is reasonable, prudent and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective PGACs based upon annual demand requirements; and

(3) whether it is reasonable, necessary and in the public interest to impose conditions upon the applicants in connection with their decision to enter into the proposed agreements and contracts.[5] Commission staff, the applicants, and the intervenors[6] stipulated to these proposed issues, as well as a procedure and schedule for disposition of this proceeding. (PSC REF#: 300956.)

JURISDICTIONAL STATEMENT

As noted above, the applicants request declaratory rulings pursuant Wis. Stat. § 227.41, which states that "any agency may, on petition by any interested person, issue a declaratory ruling with respect to the applicability to any person, property or state of facts of any rule or statute enforced by it." Because the Commission may issue a declaratory ruling concerning a "state of facts," the Commission may wish to impose a condition that any declaratory rulings that it may issue are strictly based on the set of facts established in this proceeding, are only valid to the extent that set of facts remains in place, and are void to the extent that set of facts changes.

In response to an informal Commission staff inquiry, the applicants state in a brief on jurisdiction and scope that the Commission routinely grants declaratory rulings regarding the prudence of proposed transactions that do not otherwise require Commission approval. (PSC REF#: 299529, confidential; PSC REF#: 299530, public.) In particular, the applicants state that where the proposed transaction "will ultimately affect customers' rates," the Commission has general and ratemaking authority to issue declaratory rulings regarding the prudence of the proposed transaction under Wis. Stat. §§ 196.02 and 196.03, respectively.

[5] This agenda memorandum generally addresses the first two issues expressly and separately below, but addresses the third issue regarding conditions at various points throughout the agenda memorandum in context.
[6] The intervenors are the Citizen's Utility Board (CUB), Wisconsin Industrial Energy Group (WIEG), ANR Pipeline Company (ANR), and Initiative for Competitive Energy, Inc. (ICE). (PSC REF#: 298721; PSC REF#: 298795; PSC REF#: 298814; PSC REF#: 300896.)

In order to ensure that issuing declaratory rulings is within the Commission's general and ratemaking authority under Wis. Stat. §§ 196.02 and 196.03, respectively, the Commission may wish to impose a condition prohibiting the applicants from incurring a charge under the proposed transaction except in accordance with Wisconsin law or from seeking to reflect in rates any cost incurred or revenue earned under the proposed transaction except as permitted by the Commission in this docket. *See In re Duke Energy Corp.*, 2006 WL 1559336 (N.C.U.C. Mar. 24, 2006) (imposing condition on merger that resulting wholesale power contracts between affiliated entities "must provide that Duke Power may not (a) make or incur a charge under the contract except in accordance with North Carolina law, or (b) seek to reflect in rates any cost incurred or revenue earned under the contract except as permitted by the Commission.").

The applicants further state that, in addition to falling within the scope of Wis. Stat. § 227.41, issuing declaratory rulings regarding the prudence of the proposed transaction falls within the authority left to the Commission under the Natural Gas Act. For instance, in their brief on jurisdiction and scope, the applicants addressed the applicability of *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). There, the Court held that the Mississippi Commission was preempted from reviewing the prudence of a retail utility's participation in a FERC-jurisdictional agreement allocating the capacity and costs of a nuclear power plant between the retail utility and its affiliates, including a wholesale generating company and other retail utilities. The applicants state that *Mississippi* is inapplicable because each of the applicants will enter separate agreements with BGH, as opposed to a FERC-jurisdictional allocation agreement among themselves and BGH. The applicants state that the proposed transaction is instead governed by the principle established in *Pike Cnty. Light and Power Co. v. Pa. Pub. Util. Comm'n*, 465 A.2d 735 (1983), and *Ky. W. Va. Gas Co. v. Pa. Pub.*

Util. Comm'n, 837 F.3d 600 (3d. Cir. 1988). The principle established in these cases is that where a retail utility has a choice among suppliers, the Commission, rather than FERC, may evaluate whether the retail utility was prudent in selecting a particular supplier among available alternatives.

In order to ensure that the applicants have a choice among suppliers, as the applicants claim, the Commission may wish to impose a condition requiring provisions in the storage service agreements stating that the applicants have entered into them with their affiliate BGS or BGH voluntarily and are not obligated to make any purchases. *See In re Duke Energy Corp.*, *supra*, 2006 WL 1559336 (citing *Mississippi*, 487 U.S. 354; *Ky. W. Va. Gas Co.*, 837 F.2d 600; *Pike Cnty.*, 465 A.2d 735) ("Thus, to protect the Commission's jurisdiction from preemption after the Merger, a condition must be imposed to ensure that contracts entered into by Duke Power for the purchase of electricity from affiliates are voluntary and do not obligate Duke Power to make any purchases. Regulatory Condition No. 1 explicitly requires this.").[7] Lastly, the Commission may wish to impose a condition requiring the applicants to file with the Commission the storage service agreements with their affiliate BGS or BGH before filing them with FERC in order for the Commission to determine, with the cooperation of the applicants, whether it has jurisdiction under Wis. Stat. § 196.52.[8] *See In re Duke Energy Corp.*, *supra*,

[7] The Commission could similarly impose a condition prohibiting the applicants from asserting that the Commission is preempted from assessing the reasonableness and prudence of the applicants' decision to enter the service storage agreements with BGS or BGH or related matters in the future. *See In re Duke Energy Corp.*, *supra*, 2006 WL 1559336 ("Regulatory Condition No. 8 specifically prohibits Duke Power and its affiliates from asserting that approval by the FERC of market-based rates, transfers of generating facilities, or any matter that involves affiliates in any way preempts the Commission's authority to determine the reasonableness or prudence of Duke Power's decisions with respect to supply-side resources, demand-side management, or any other aspect of resource adequacy.").

[8] Indeed, in docket 5-AE-208, WEPCO and WPSC have sought Commission approval of a purchase power agreement between the affiliated public utilities under Wis. Stat. § 196.52, despite the fact that they are also seeking FERC approval under the affiliate abuse standard established in *Boston Edison Co. Re: Edgar Elec. Energy Co.*, 55 FERC ¶ 61,382 (1991) (*Edgar*). Under *Edgar*, FERC "must ensure that the buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and nonprice terms (*i.e.*, that it has not preferred its affiliate without justification)." *Id.*

2006 WL 1559336 ("In order to enable the Commission to determine if it has jurisdiction over the proposed Affiliate Contract or amendment and how it will exercise its jurisdiction, Duke Power shall file a notice and a copy of the proposed Affiliate Contract or amendment with the Commission 30 days prior to a filing covered by this condition being made with the FERC.").

DISCUSSION

Review of the Applicants' Economic Analysis of the Proposed Transaction[9]

Summary of the Applicants' Economic Analysis

In their economic analysis,[10] the applicants evaluated the impact of the proposed transaction on customers. The applicants compared the NPV cost of the proposed transaction to the projected NPV cost of continuing to contract for storage and transportation services on a shorter term basis, which has been the traditional approach utilized to meet customer needs. The cost of the proposed transaction was specified as the "Base Case," and the projected cost of continuing with the status quo was specified as the "Alternative Case." Various scenarios were evaluated to provide a range of reasonable potential outcomes.

As stated in the application, the economic evaluation the applicants performed was an avoided cost analysis in which the cost of purchasing the Bluewater facility, on-going operating costs and revenues, and firm transportation costs for delivery of natural gas storage from the Bluewater facility to Guardian was compared against continued contracting for storage and transportation on shorter terms over the life of the investment. The NPV of the annual costs for each case was calculated and compared to derive the savings provided by the proposed

[9] In addition to assessments of various components of the gas storage agreements discussed above, the following section addresses the first issue in the Order to Open Docket and Notice of Prehearing Conference: whether it is reasonable, prudent and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility.

[10] The applicants' economic analysis is contained in Attachment 5 to the application.

transaction relative to the applicants continuing their current practice of contracting for storage and transportation services on a shorter-term basis.

The applicants state that in the Base Case, as compared to leasing similar amounts of gas storage and transportation capacity on a shorter-term basis, the proposed transaction will reduce the applicants' purchased gas costs by about $200 million NPV over the next 60 years, a reduction of about [redacted]. The applicants state that in the "high storage cost" case, which models a hedge against higher costs in the future, the total benefits of the proposed transaction could increase to [redacted]. Last, the applicants state that in the "low storage cost" case, which tests whether the proposed transaction will reduce the applicants' purchased gas cost even if the storage costs do not increase as much as in the Base Case, the total benefits were still [redacted]. (PSC REF#: 297633, Attachment 5 at 26-27.)

Summary of Commission Staff's Review of the Applicants' Economic Analysis

Commission staff reviewed and analyzed the applicants' economic analysis. In general, Commission staff did not identify any deficiencies in: (1) the framing of the applicants' economic analysis in light of their stated economic objectives;[11] (2) the quality of the applicants' model; or (3) the quality of the applicants' data. Commission staff did not identify any inconsistencies between the application, the economic analysis, or data request responses. Commission staff has identified concerns in several areas, however. First, Commission staff identified concerns with the discount rate the applicants used in their economic analysis. Second, Commission staff has identified concerns regarding the 60-year length of the gas storage

[11] Commission staff notes that the applicants did not attempt to quantify any economic benefits of the proposed transaction that are outside of their stated economic objectives, which could become material considerations, as reflected in the range of applicable discount rates.

contracts. Last, Commission staff has identified concerns regarding the capital expenditure growth rate the applicants used in their economic model. Further, while not necessarily a concern, Commission staff conducted stress testing to estimate how economically severe potential catastrophic events occurring at various points throughout the 60-year length of the proposed transaction would need to be in order to eliminate NPV savings.

Discount Rate

The applicants used a blended weighted average cost of capital (WACC) based on their most recent rate cases, which is equal to 7.19 percent. (PSC REF#: 299837 at 1-2.) The applicants state that the WACC is appropriate to use as a discount rate because the economic structure is designed to closely resemble a rate case investment, and the WACC would likely have been applied to that new asset in a rate case proceeding. The applicants further state that Bluewater will have a similar overall capital structure to the applicants and will be able to obtain financing on comparable terms to the applicants. The applicants lastly state that the WACC will be updated after the Commission approves new WACCs for the applicants in rate cases.

Commission staff is concerned that the blended 7.19 percent WACC may be understated, primarily due to the cost of equity estimate adopted and the capital structure used in calculating the blended WACC. Commission staff therefore is concerned that the NPV of projected savings may be consequently overstated. Specifically, the applicants' discount rate does not attempt to reflect the specific risks and financial characteristics associated with an investment in a natural gas storage facility. Instead, it reflects the risks and financial characteristics of the applicants themselves. The rates of return reflect historical and outdated market levels dating back to each

applicants' last rate case.[12] Similarly, the classes of capital used reflect the capital structures of the applicants rather than the funding that might be appropriate for an investment in a natural gas storage facility.

Commission staff believes that it would have been reasonable for the applicants to have used a marginal WACC in their economic analysis. The marginal WACC is the result of estimating the blend of classes of capital to be used in funding the proposed transaction in particular, the marginal cost of each class of capital in the required amounts at the time the analysis is to be undertaken, and any tax benefits derived from the tax deductibility of interest payments made on the debt raised for the proposed transaction. The marginal WACC reflects the marginal risks associated with a particular project at the time it is being considered and represents the opportunity cost incurred by a potential investor who would have otherwise been able to make an alternative investment of comparable risk and other financial characteristics.[13]

Using a marginal WACC and the applicants' calculated marginal tax rate of [redacted], Commission staff believes that an appropriate discount rate would range between 7.92 percent and 11.34 percent, with 9.53 percent being a reasonable point estimate. Commission staff developed this range as follows.[14] First, Commission staff believes that an appropriate return on equity required for the proposed transaction ranges between 13 percent and 17 percent. Second, Commission staff believes that the cost of debt required for the proposed transaction would range between 3.79 percent and 5.5 percent before tax for 30- and 60-year senior unsecured

[12] The last full rate case of WEPCO and WG was in docket 5-UR-107, decided on December 23, 2014, which included a contested return on equity. (PSC REF#: 226564.) The last full rate case for WPSC was in docket 6690-UR-124, decided on December 17, 2015, which also included a contested return on equity. (PSC REF#: 279522.)

[13] This opportunity cost also reflects the value of the alternative benefits foregone as a result of WEC voluntarily limiting the use of the natural gas storage facility to the proposed storage services over 60 years.

[14] Commission staff relied on the following sources in developing this range: The Federal Reserve Board, Bloomberg, FERC, and the U.S. Energy Information Agency, *inter alia*.

unamortizing debt respectively, with 4.65 percent being a reasonable point estimate. Last, Commission staff believes that an appropriate capital structure for the proposed transaction would range between 40 percent to 50 percent long-term debt-to-total capitalization ratio, with 45 percent being a reasonable point estimate.

Using the lower discount rate of 7.92 percent would result, by itself, in $112 million, or 18 percent, in NPV savings for the proposed transaction. Using the median discount rate of 9.53 percent would result, by itself, in $11 million, or 2 percent, in NPV savings for the proposed transaction. And using the higher discount rate of 11.34 percent would result, by itself, in (-$63 million), or (-17 percent), in NPV savings for the proposed transaction. These impacts are independent of other factors discussed below.

Length of the Proposed Gas Storage Agreements

Commission staff is also concerned with the 60-year time horizon of the proposed transaction. In Commission staff's estimation, 60 years may constitute a significantly long period in the natural gas industry, which has undergone significant shifts in supply recently, primarily because of the exponential growth of uncertainty over time. This uncertainty can be summarized as follows:

- The longer the period being forecasted, the broader the potential dispersion of outcomes, and therefore, the greater the financial risk;
- Each consecutive time period has its own dispersion, which widens the range of potential outcomes for the subsequent period; and
- Absent any risk buffering or contractual limitations, that increasing risk over 60 years is transferred from WEC to the applicants' customers.

The effect of the 60-year length may be illustrated by considering a cash flow of $1.00 that is expected to occur every year, with a probability distribution curve that centers on $1.00 for the next 60 years and with extreme distribution dispersion points that are 1 percent above and below that $1.00 central value. At the end of the first year, the two extreme distribution points expand to $1.01 and $0.99, with the expected outcome remaining at $1.00. At the end of the second year, the two extreme distribution points expand to $1.02 and $0.98, with the expected outcome remaining at $1.00. At the end of the 60 years, however, the two extreme distribution points expand to $1.82 and $0.55, even though the expected outcome still remains constant at $1.00. This example demonstrates that as the time horizon grows, the likelier it becomes that low-probability, material events, many of which cannot be feasibly hedged, will occur.

To further illustrate the effect of the 60-year length, the Commission may also wish to consider the previous 60 years in the natural gas market. At the beginning of this period, much of Wisconsin relied on city or manufactured gas and on bottled propane and butane. The technology and engineering associated with natural gas was far less developed than with today's advances in lateral drilling and hydraulic fracturing (fracking). Natural gas was, at that time, considered the accidental by-product of petroleum exploration and production, and not its objective, and was often flared off because it was uneconomic to capture, dry, and transport to potential customers. Clearly, the market has evolved during the past 60 years. Bundled services have been unbundled, natural gas has become a cleaner fuel than coal, and natural gas has displaced nuclear fuel in some markets as the most economic for baseload generation.

While the applicants' economic analysis attempts to capture some of the expected changes in the natural gas market over the next 60 years, it does not necessarily capture two significant types of potential changes. First, the applicants' economic analysis does not consider

the nature and impact, including increased opportunity costs, of changes that could limit the applicants' natural gas storage needs to the point where the proposed 60-year gas storage contracts may be unnecessary. Second, the applicants did not quantify the nature and impact of potentially catastrophic events, such as a well blow-out event of the type that occurred at the Aliso Canyon facility near Los Angeles, California.

The 60-year length of the proposed transaction also highlights that WEC and the applicants have constrained the potential value of the Bluewater facility to only that which can be delivered to the applicants. For instance, natural gas storage facilities have value which can be derived from more than one function and applied to more than one type of business. The limited scope and nature of the proposed transaction creates opportunity costs that will vary over the Bluewater facility's 60-year length. Long-term fluctuations in the following areas may influence long-term risks of the proposed transaction: (1) the relative pricing of alternative storage and delivery services; (2) changes in supply and demand for natural gas among the applicants existing and future customers; (3) technological changes and engineering advances affecting the range of potential producers and users of natural gas; and (4) the availability and cost of alternative fuels for heating and generation. Flexibility in the use of the Bluewater facility would reduce potential risk to the applicants directly as well as indirectly impact WEC's cost of equity and by extension the applicants' cost of equity.

Given the 60-year length of the contract, the Commission may wish to impose several conditions to help mitigate potential risks. First, the Commission may wish to impose a condition under which the Commission reconsiders, in part under its authority in Wis. Stat. § 196.52, the reasonableness of the proposed gas storage contracts every 10 or 15 years based on any potential changes to the natural gas market, the applicants' industry, the

applicants' customer needs, and the regulatory, business, and legal environment within which the applicants operate. Second, the Commission may wish to impose conditions requiring the applicants to include provisions in the gas storage contracts allowing for cancellation or renegotiation if events materially affecting the economic savings of the proposed transaction occur. Third, the Commission may wish to impose a reporting condition requiring the applicants to periodically submit information that would allow Commission staff to verify that the proposed transaction is in fact creating customer savings.

Growth Rate

The applicants used an annual capital expenditure growth rate of 3 percent throughout the life of the proposed transaction. (PSC REF#: 299837 at 3.) Commission staff determined that NPV savings is very sensitive to the growth rate in operations, maintenance, and capital expenditures, which reflects the high operating leverage in this industry. Given this sensitivity, Commission staff therefore studied the impact of three higher growth rates in the applicants' economic model to test its potential impact on the economic viability of the proposed transaction. Using a growth rate of 5 percent would result in $133 million, or 18 percent, in NPV savings. Using a growth rate of 7 percent would result in $11 million, or 2 percent, NPV savings. And using a growth rate of 9 percent would result in (-$245 million), or (-34 percent), in NPV savings.

The Commission may also wish to consider the applicants' use of a straight line growth rate. While using a straight line growth rate may be simpler and may result in a NPV-neutral outcome, it also masks the impact of volatility in the future that can affect cost recovery and customer bills. For instance, a reasonable average constant rate of increase may not accurately

reflect actual volatility. This is especially important where the applicants seek recovery of the proposed transactions' costs through their PGACs.

Stress Testing

Given the 60-year length of the proposed transaction and the related concerns discussed above, Commission staff stress tested the applicants' Base Case to determine what dollar value would be required to cancel the NPV savings at various points through the 60 years. This dollar value, presumably associated with unlikely but catastrophic events, would be considered the economic tipping point for the proposed transaction. These dollar values are as follows:

- Year 5: $865 million; Year 10: $980 million; Year 15: $1,105 million; Year 20: $1,350 million; Year 25: $1,650 million; Year 30: $2,150 million; Year 35: $2,700 million; Year 40: $3,500 million; Year 45: $4,600 million; Year 50: $6,150 million; and Year 55: $8,200 million.

If Commission staff's assumptions were used in this stress test, the various tipping points indicated above would be lower. In any event, given these relatively high figures, Commission staff concludes that the applicants' Base Case seems reasonably robust in this regard.

Recovery of the Proposed Transaction's Costs Through PGACs[15]

Overview of Gas Cost Recovery Process

Whether it is reasonable, prudent, and in the public interest for the applicants to recover the costs of the proposed transaction through their respective PGACs requires a description of the gas cost recovery process. The Commission developed PGACs to correct over-recovery or

[15] In addition to the general background provided above, the following section addresses the second issue in the Order to Open Docket and Notice of Prehearing Conference: whether it is reasonable, prudent and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective PGACs based upon annual demand requirements.

under-recovery of commodity-related gas costs, which generally include storage and transportation costs (but not plant or other assets) either because of changes in the cost of gas supplies or customer usage different than anticipated in base rates. *See Order in GCRM Docket*, *supra*, 1996 WL 34720600, at *2. Based on the nature of the gas industry in the late 1980s and early 1990s, the Commission developed PGACs because LDCs were seen as price takers without the ability to influence the amount they could pay for gas supplies. *Id.* at *2-*7.

Under the Commission's gas cost recovery process, "[t]he price seen on bills by utility customers represent[s] rates for service that have been developed and affected by both ratemaking conventions and gas cost recovery mechanisms [*i.e.*, PGACs]." *Id.* at *13-*14. "In regard to ratemaking conventions, the estimated annual gas costs for a utility in a rate case are assigned or allocated to the various customer rate classifications. These assignments and allocations result in the base rates for utility service." *Id.* at *14. However, gas cost recovery mechanisms, such as PGACs, "recover the differences between the estimates used in developing the base cost of gas rates and the actual gas costs that are relevant to the current monthly gas volumes actually acquired and used to provide customer service." *Id.*

To effectuate the gas cost recovery process, the Commission requires public utilities to submit gas supply plans for Commission approval. *See, e.g.*, *id.* at *20. The Commission has found this to be "a reasonable means for assessing a [public] utility's entire portfolio." *Id.* at *38. Gas supply plans must include, among other things, volume and cost-related data on pipeline and storage facility capacity contracts. *Id.* Costs incurred in accordance with approved gas supply plans will be passed on to ratepayers. *Id.* at *22. As such, changes in these forecasts must obtain Commission approval. *Id.* at *39. Cost increases not included in an approved gas supply plan may not pass through PGACs until approved. *Id.* at *40.

In sum, the average base cost of gas is determined during a public utility's rate case. The source of supply, throughput data, and the purchased gas to sales ratio are derived from the public utility's most recently approved gas supply plan. When the public utility's cost of natural gas supply or sales data changes from the estimates reflected in the base average gas costs, new rates for average gas costs are calculated and the cost difference is recovered through the PGAC.

Criteria for Developing and Using PGACs

Based on an evolution of the gas industry since the late 1980s and early 1990s when the Commission developed PGACs, LDCs can now exercise a level of control over the price they pay for gas supplies. Thus, the Commission has established a number of criteria for gas utilities' development and use of gas cost recovery mechanisms. First, reliable service must be maintained under any acceptable gas cost recovery mechanisms. *Id.* at *10. Second, the sharing of risk and reward should be balanced between shareholders and ratepayers. *Id.* at *11. Third, the operation of gas cost recovery mechanisms should provide appropriate price signals. *Id.* at *13. Fourth, the operation of gas cost recovery mechanisms should not unduly hinder the transition to workable markets. *Id.* at *14. Fifth, the operation of gas cost recovery mechanisms should be designed to achieve the lowest reasonable cost of gas to its customers via the submission of gas supply plans. *Id.* at *16. Sixth, the Commission must have detailed and timely information in order to carry out its regulatory responsibilities. *Id.* at *17. Finally, gas cost recovery mechanisms should minimize the need for retrospective review of utility transactions. *Id.* at *18. The applicants state that the proposed transaction's costs should be recovered through their PGACs because their existing BGH contracts are recovered through their PGACs and that the proposed transaction meets the guiding principles noted above.

(PSC REF#: 299839, confidential; PSC REF#: 299840, public.)

Applicants' Basis for Recovery of the Proposed Transaction's Costs Through PGACs

First, the applicants state that recovery through their PGACs provides reliable service at reasonable costs because it provides: (1) significant, positive net present value; (2) long-term certainty akin to ownership; (3) operational access to market-area storage; and (4) access to long-term storage service at known savings. Second, the applicants state recovery through their PGACs shares risk and reward among shareholders and ratepayers. In particular, the applicants state that shareholders forego the opportunity to invest capital elsewhere for 60 years, while ratepayers acquire storage facilities at costs consistent with other utility investments. The applicants further state that additional significant capital investment will be subject to Commission review, and that the potential for opportunity sales will accrue to ratepayers, not shareholders. Third, the applicants state that recovery through their PGACs will provide timely and appropriate price signals to customers because the method of pricing working gas in storage will not change and that monthly PGAC filings and true-ups will facilitate prompt pricing adjustments. Fourth, for these same reasons, the applicants state that recovery through their PGACs will not thwart the development of workable competitive markets. Fifth, the applicants state that submitting the required gas supply plans will allow the Commission to determine whether the operation of the gas cost recovery mechanisms are operated in a way to achieve the lowest reasonable cost of gas. Sixth, the applicants state that they will provide the Commission with detailed, timely, consistent, and standardized information through the required PGAC reporting. Last, the applicants state that the Commission's issuance of the requested declaratory rulings will achieve the goal that operation of gas cost recovery mechanisms should minimize the need for retrospective reviews of utility transactions.

Recovering the proposed transaction's transportation contract costs through the applicants' PGACs may be reasonable based on the applicants' current practice of recovering similar transportation contract costs in their PGACs. The lengths of the proposed transaction's transportation contracts are not unreasonable, and in past gas supply plans, the Commission has approved the use of both short- and long-term transportation contracts. Currently, WE-GO, WG, and WPSC have short- and long-term storage transportation contracts with other companies ranging from 1 to 18 years in length. In addition, several other Wisconsin gas utilities have long-term storage transportation contracts ranging from 10 to 29 years in length. Further, the current and expected pricing of the transportation capacity needed to inject and withdraw natural gas in and out of storage via the Vector and Guardian pipelines is significantly lower than ANR's tariffed transportation service.

Commission staff has identified potential areas of concern regarding recovery of the gas storage agreements through the PGACs where such recovery may not appropriately balance risk and reward among shareholders and ratepayers. If the applicants are permitted to recover the gas storage contracts on a one-for-one basis through their PGACs, the applicants' ratepayers bear all the risk associated with the 60-year contracts. The applicants would be guaranteed recovery of all charges incurred under the gas storage contracts regardless of how the market may change, and the ratepayers would be required to pay for such contracts even if they prove uneconomic in the future. As discussed below, recovery of gas storage agreement costs through base rates may more appropriately balance risk and reward among shareholders and ratepayers. However, if the Commission believes that recovery of the gas storage agreements through the applicants' PGACs appropriately balances the sharing of risk and reward between shareholders and ratepayers, among the other criteria noted above, the Commission could deem reasonable and prudent the

applicants' request. If the Commission deems reasonable and prudent the applicants' request, the Commission may wish to consider imposing a review condition given the novelty of recovering gas storage agreements of this length through PGACs. For instance, the Uniform System of Accounts for a private utility requires that plant for which a utility seeks rate recovery be both "used" and "useful." In other words, to seek recovery for plant acquired by a utility, it must possess the capacity to benefit the public interest (useful) and to be utilized for benefit of the public interest (used). If the Commission were to grant recovery of the proposed transaction through the PGACs, the Commission may wish to impose a condition requiring that the gas storage contracts be evaluated under these criteria every 3 years.

Recovery of Gas Storage Agreement Costs Through Base Rates

If the Commission does not believe that the recovery of the gas storage contract costs through the applicants' PGACs fairly balances risk and reward among shareholders and ratepayers, the other manner in which these gas storage contract costs would be recovered is strictly through base rates similar to how a rate base asset would be recovered, as noted above. Including these gas storage contract costs in base rates does not guarantee full recovery of all costs, but would allow the applicants a reasonable opportunity to recover prudently incurred costs under their contracts with BGS. This approach may appropriately balance risk and reward. The reward is that the applicants would be allowed to retain any opportunity sales or benefits from increased sales or other cost savings. Potential risk to the applicants would result from the potential for decreased sales and unanticipated expenses, which may prohibit the applicants from fully recovering costs. Two WEC subsidiaries currently own underground storage facilities, the Manlove Field and the Partello Field. (*See* PSC REF#: 297634 at 17). These storage facilities and the associated base gas are treated as rate based assets, and the costs associated with them

are recovered through state (Michigan and Illinois) rate case processes. Likewise, the O&M expenses incurred relative to these facilities are recovered in base rates.

In [redacted], Madison Gas and Electric Company (MGE) purchased a [redacted] (PSC REF#: 275907, confidential; PSC REF#: 275908, public.) The costs MGE incurred for purchasing and operating the plant were recovered through base rates. [redacted]

Similarly, the applicants previously proposed in a rate case to recover the carrying cost of gas-in-storage through their PGACs, which would guarantee earning the authorized return on associated investment in stored natural gas. *See In re Wis. Elec. Power Co.*, Docket No. 5-UR-103, 2008 WL 294759, at *57 (Pub. Serv. Comm'n of Wis. Jan. 17, 2008). The applicants asserted that with "volatility in the natural gas market, it is unreasonable to hold the utility and its shareholders responsible for changes in the carrying costs on the gas inventory when the PGA[C] mechanism could be used to accommodate fluctuations in natural gas costs and inventory levels." *Id.* The Commission denied the request, holding that it was inconsistent with: (1) prior Commission decisions denying similar requests for the applicants; and (2) the Commission's findings in the *Order in GCRM Docket*. 2008 WL 294759 at *58. The Commission noted that LDCs could "no longer claim to be mere 'price takers' but rather must be viewed as players whose expertise, judgment, and dedication are able to significantly affect the delivered price they pay for gas supplies." *Id.* (quoting *Order in GCRM Docket*, *supra*, 1996 WL 34720600, at *6). The Commission required the applicants to recover the carrying cost of gas-in-storage through margin (base) rates given their forward-looking nature. 2008 WL 294759 at *58.

If the Commission decides that the storage contract costs be recovered strictly through base rates, treatment of the proposed transaction as an operating lease on the applicants' books allows the applicants to reflect their interest in the storage facilities without implying ownership. A lease is defined as a contractual agreement between a lessor and a lessee that gives the lessee the right to use specific property, owned by the lessor, for a specific period of time in return for stipulated, and generally periodic, cash payments (rents)." (Kieso and Weygandt, *Intermediate Accounting*, at 1159.) Because of this, and consistent with its traditional treatment of these transactions as "leases" identified in page 2, footnote 2 of the application, if this transaction were presented in a rate case proceeding, the agreement would qualify as a lease. The Investor-Owned Utility Uniform System of Accounts states that "[a]ll leases shall be classified as either capital or operating leases." ASC 840-21-1 provides that to be considered a capital lease, the lease agreement must meet the following four requirements:

a. Transfer of ownership. The lease transfers ownership of the property to the lessee by the end of the lease term. This criterion is met in situations in which the lease agreement provides for the transfer of title at or shortly after the end of the lease term in exchange for the payment of a nominal fee, for example, the minimum required by statutory regulation to transfer title.

b. Bargain purchase option. The lease contains a bargain purchase option.

c. Lease term. The lease term is equal to 75 percent or more of the estimated economic life of the leased property. However, if the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property, including earlier years of use, this criterion shall not be used for purposes of classifying the lease.

d. Minimum lease payments. The present value at the beginning of the lease term of the minimum lease payments, excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor, including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property to the lessor at lease inception over any related investment tax credit retained by the lessor and expected to be realized by the lessor. If the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased

> property, including earlier years of use, this criterion shall not be used for purposes of classifying the lease.

Because each applicant's relative share of the capacity does not satisfy any of the above requirements, the agreement would be classified as an operating lease. The lease payments in a rate case would include a cost component for depreciation on the plant, a rate of return on the equity component on financing, interest expense, O&M, and any income taxes associated with the facilities. The applicants would annually submit forecast changes based on the above information and request inclusion of costs in the revenue requirement.

Another issue related to the proposed transaction's cost recovery is the applicants' stated acquisition premium. As noted above, the Commission may not necessarily be permitted to disallow the acquisition premium in this case because it is a component of the FERC rate. But if the Commission determines that it has the authority to disallow the acquisition premium and wishes to do so, selecting the appropriate cost recovery mechanism is critical to that determination. For instance, if the Commission were to grant recovery of the proposed transaction's costs through the PGACs, the Commission would not be able to evaluate the criteria concerning acquisition premium recovery in the Commission's internal memorandum dated April 17, 1985, discussed above, as recovery under the PGACs does not allow for such discretion or consideration. However, if transaction costs were recovered strictly through base rates, the Commission could disallow recovery of any acquisition premium unless the applicant can demonstrate the benefit to ratepayers of allowing recovery of it.

The BGS contract year begins on [redacted] and ends on [redacted]. Typically, the applicants file their rate case application in April. Therefore, the applicants would have actual costs for the first [redacted] months of the year, but would need to forecast the anticipated true-up

costs for the remainder of the test year. If the Commission finds that it is not reasonable and prudent to recover the gas storage contract costs through the PGACs, the total costs that would be included in rate base would be the current base reservation charge, actual known true-up cost, and the test-year forecasted true-up expenses. The applicants anticipate beginning to incur costs under the gas storage contracts in the short term. Currently, the applicants have filed for a base rate freeze for gas rates through 2019. (PSC REF#: 300739; PSC REF#: 300749.) If the Commission finds that it is reasonable and prudent to recover the gas storage contract costs through base rates, the Commission may wish to allow the applicants to either defer the costs or recover them through their PGACs until each of the applicant's next full rate case. Recovering the costs through the PGAC until the next rate case may also allow the applicants to gain operational experience without risk of under-recovery.

Effect of a Commission Declaratory Ruling that the Proposed Transaction is Not Reasonable and Prudent

If the Commission ultimately determines that it is not reasonable and prudent for the applicants to enter the proposed transaction, that does not, in itself, prohibit the applicants from actually entering the proposed transaction. No Wisconsin law otherwise prohibits WEC from purchasing BGH and operating in the wholesale market. If, by operating within the wholesale market, WEC could offer the applicants contracts under typical arrangements subject to FERC tariffs, that could potentially be beneficial to the applicants and their ratepayers as well.

COMMISSION ALTERNATIVES

Prudency and Reasonableness of the Proposed Transaction

Alternative One: Find that it is reasonable, prudent, and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility as filed.

Alternative Two: Find that it is reasonable, prudent and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility with any of the conditions discussed above and further recited below.

Alternative Three: Find that it is not reasonable, prudent, and in the public interest for the applicants to enter into long-term storage service agreements and related interstate gas transportation contracts in connection with the Bluewater facility.

Cost Recovery Mechanism

Alternative One: Find that it is reasonable, prudent, and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective purchase gas adjustment clauses based upon annual demand requirements as filed.

Alternative Two: Find that it is reasonable, prudent, and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective purchase gas adjustment clauses based upon annual demand requirements with any of the conditions discussed above and further recited below.

Alternative Three: Find that it is not reasonable, prudent, and in the public interest for applicants to recover their allocated portions of the full cost of acquiring the Bluewater facility and all of the reasonable and prudent expenses of operating and maintaining the facility through their respective purchase gas adjustment clauses based upon annual demand requirements.

Potential Conditions

1. The declaratory rulings are strictly based on the set of facts established in this proceeding, are only valid to the extent that set of facts remains in place, and are void to the extent that set of facts changes.

2. The applicants are prohibited from incurring a charge under the proposed transaction except in accordance with Wisconsin law or from seeking to reflect in rates any cost incurred or revenue earned under the proposed transaction except as permitted by the Commission in this docket.

3. The applicants must include provisions in the storage service agreements stating that the applicants have entered into them with their affiliate BGS or BGH voluntarily and are not obligated to make any purchases.

4. The applicants are prohibited from asserting that the Commission is preempted from assessing the reasonableness and prudence of the applicants' decision to enter the service storage agreements with BGS or BGH or related matters in the future.

5. The applicants are required to file with the Commission the storage service agreements with their affiliate BGS or BGH before filing them with FERC in order for the Commission to determine, with the cooperation of the applicants, whether it has jurisdiction under Wis. Stat. § 196.52.

6. Under its authority in Wis. Stat. § 196.52, the Commission will reassess reasonableness of the proposed gas storage contracts every 10 or 15 years based on any potential changes to the natural gas market, the applicants' industry, the applicants' customer needs, and the regulatory, business, and legal environment within which the applicants operate.

7. The applicants are required to include provisions in the gas storage contracts allowing for cancellation or renegotiation if events materially affecting the economic savings of the proposed transaction occur.

8. The applicants are required to periodically submit information that would allow Commission staff to verify that the proposed transaction is in fact creating customer savings.

9. The Commission will reassess the reasonableness of recovering gas storage contracts costs through the PGACs under the used and useful standard every 3 years.

10. If the Commission determines that recovery of the proposed gas storage contract costs through the PGACs is not reasonable and prudent, the Commission will treat these contracts as operating leases on the applicants' books.

11. If the Commission determines that recovery of the proposed gas storage contract costs through the PGACs is not reasonable and prudent, the applicants may either defer the costs or recover them through their PGACs until each of the applicants next full rate case.

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Key Background Documents
MGE Request for Approval to Replace Existing Capacity (CONFIDENTIAL) - PSC REF#: 275907
MGE Request for Approval to Replace Existing Capacity (REDACTED COPY) - PSC REF#: 275908
MI NGS Project Application (CONFIDENTIAL) - PSC REF#: 297633
MI NGS Project Application (REDACTED COPY) - PSC REF#: 297634
Request to Intervene of ANR Pipeline Company - PSC REF#: 298721
WIEG Motion to Intervene and Notice of Appearance - PSC REF#: 298795
CUB Request for Intervention - PSC REF#: 298814
Brief on Jurisdiction and Scope (CONFIDENTIAL) - PSC REF#: 299529
Brief on Jurisdiction and Scope (REDACTED COPY) - PSC REF#: 299530
3-23-17 Commission Agenda Memorandum - PSC REF#: 299828
Data Request Response to PSC-2 - PSC REF#: 299835
Data Request Response to PSC-3 - PSC REF#: 299836

REDACTED